

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
MICHAEL LENHARD : DETERMINATION
for Redetermination of a Deficiency or for :
Refund of Personal Income Tax under Article 22 :
of the Tax Law for the Period January 1, 1977 :
through December 31, 1982. :

Petitioner, Michael Lenhard, 36 Ivory Way, Henrietta, New York 14467, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the period January 1, 1977 through December 31, 1982 (File No. 801335).

A hearing was commenced before Arthur S. Bray, Hearing Officer, at the offices of the State Tax Commission, 259 Monroe Avenue, Rochester, New York, on June 3, 1987 at 1:30 P.M. and was concluded before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, at the same location on December 2, 1987 at 9:15 A.M., with all briefs to be filed by April 25, 1988. Petitioner appeared by Lacy, Katzen, Ryen & Mittleman (Don H. Twietmeyer, Esq. and Reid A. Holter, Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (James Della Porta, Esq., of counsel) at the hearing on June 3, 1987 and by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel) at the hearing on December 2, 1987.

ISSUES

I. Whether a pending bankruptcy proceeding involving FML Supply, Inc. prevents the Division of Tax Appeals from adjudicating the withholding tax liability of petitioner.

II. Whether petitioner is liable for the penalty asserted against him pursuant to Tax Law § 685(g) with respect to New York State withholding taxes due from FML Supply, Inc.

III. Whether it was an error for the Audit Division to apply certain checks designated for withholding tax to petitioner's outstanding sales tax liability.

FINDINGS OF FACT

1. On May 21, 1984, the Audit Division issued a Notice of Deficiency to petitioner, Michael Lenhard, asserting a deficiency of personal income tax for the years 1977, 1981 and 1982 in the amount of \$34,202.22. The Statement of Deficiency, which was also issued on May 21, 1984, explained that the Audit Division was asserting the deficiency against petitioner as a person required to collect, truthfully account for and pay over the taxes withheld from the wages of the employees of FML Supply, Inc. d/b/a Lenhard's Roto Rooter ("FML"). The Statement of Deficiency listed the withholding tax periods and the respective amounts asserted to be due as follows:

<u>Withholding Tax Period</u>	<u>Amount</u>
January 1, 1977 through December 1, 1977	\$ 4,235.12
January 1, 1981 through September 30, 1981	12,717.48
January 1, 1982 through December 31, 1982	<u>17,249.62</u>
	<u>\$34,202.22</u>

2. The amount of tax asserted for the year 1977 was premised upon information provided by petitioner. Similarly, the amount of tax asserted for the years 1981 and 1982 was based upon the reported, but unpaid, withholding tax liability of FML.

3. FML was a corporation which provided plumbing service, sewer and drain cleaning, backhoe work and drilling for water service. Prior to 1977, the officers of FML were petitioner's mother, who held the office of president, and petitioner's father, who served as business manager.

4. In 1977, petitioner became the president of FML. As president, petitioner supervised the field workers, spoke with customers on the telephone and negotiated contracts. Although he did not exercise the authority, petitioner had the right as president to hire and fire employees. Similarly, although he did not frequently exercise the authority, petitioner had the authority to sign checks on behalf of the corporation.

5. After petitioner became president, the financial affairs of FML continued to be handled by petitioner's father, Kenneth B. Lenhard. Mr. Kenneth Lenhard was responsible for filing the tax returns and remitting the tax due.

6. In July 1981, petitioner's father decided that petitioner would do a better job of handling the tax matters of FML and, therefore, he turned that responsibility over to petitioner. Thereafter, petitioner visited the local office of the Department of Taxation and Finance in order to resolve FML's debt.

7. Petitioner was informed at the District Office that FML owed a substantial sum of money and that it would be closed down unless FML began making payments of \$1,000.00 a week. Thereafter, FML made an initial payment of \$5,000.00 and commenced payments of \$1,000.00 a week. These payments were made directly to the local District Office at the insistence of that office.

8. On December 7, 1981, petitioner entered into a Deferred Payment Agreement with respect to the payment of certain outstanding sales tax liabilities. The second page of the agreement contained conditions which provided, in part, as follows:

"Failure to meet the following conditions will lead to default and further enforcement action.

1. Current returns must be filed and paid on a timely basis to the Tax Compliance Bureau, P.O. Box 5046, Albany, NY 12205."

9. Petitioner continued making monthly payments until August 1983 when discussions with personnel in the Department led petitioner to believe that although he had paid over \$100,000.00 he still owed over \$100,000.00 of various taxes including sales tax and withholding

tax. Petitioner then demanded an explanation of where the money was applied. When he did not receive an explanation which met his satisfaction, he stopped making payments according to the payment agreement and started paying only current liabilities.

10. An agent of the Department threatened to close down FML when the payments pursuant to the Deferred Payment Agreement ceased. Consequently, FML filed a petition under Chapter 11 of the Bankruptcy Law in order to protect itself. The Notice of Deficiency which is the subject of this proceeding was issued after the filing of the bankruptcy petition.

11. Periodically, petitioner received documentation from the Department which reported an amount due. On occasion, this documentation did not show any liability for 1977. Similarly, although the Department asserted a claim against FML in the bankruptcy proceeding, no claim was asserted for the year 1977.

12. During the period 1977 through July 1981, petitioner was aware that FML had debts but he was not involved in paying them. Moreover, petitioner was not aware during this period of the extent of FML's tax deficiency.

13. On October 30, 1981, November 5, 1981, November 12, 1981, November 19, 1981 and November 24, 1981, bank checks were drafted designating payment of withholding tax. The checks, which total \$5,000.00, were applied to outstanding sales tax assessments.

14. In the course of the hearing, the Audit Division offered a computer printout which disclosed a number of related assessments issued against FML. One portion of the computer printout shows that, with respect to a particular assessment, the amount of tax due for the period January 1, 1983 through September 30, 1983 was \$11,849.45.

15. At some juncture, petitioner became a stockholder of FML. At the hearing, petitioner was uncertain when he first acquired the stock.

16. The Audit Division conceded at hearing that it had failed to reduce the asserted deficiency by a payment FML had made in satisfaction of a portion of its withholding tax liability for 1981. This payment was in the amount of \$3,330.46.

SUMMARY OF THE PARTIES' POSITIONS

17. At the hearing, petitioner testified that at one point he approached an individual at the District Office and advised him that the weekly payments were draining the business of cash, and as a result, FML had difficulty satisfying its tax obligations. The individual at the District Office allegedly advised petitioner to just pay the \$1,000.00 a week and he (the individual at the District Office) would take care of the current liability. Petitioner maintains that on occasion he attempted to draft checks or present money orders for the current liabilities but these checks were refused.

18. Petitioner's belief that his weekly payments were for both past and current liabilities was allegedly supported by his observation that the amount he was paying was beyond his current sales tax and withholding tax liability. Therefore, petitioner allegedly concluded that the balance beyond that necessary to meet his current liabilities was being applied to the amount past due.

19. Petitioner asserted he never received a copy of the page from the Deferred Payment Agreement which required that current liabilities be paid to Albany.

20. On the basis of the computer printout offered at the hearing (Finding of Fact "14"), petitioner argued that the amount of the deficiency of withholding tax must be limited to \$11,849.45.

21. In his brief, petitioner requested that this matter be remanded to the Department of Taxation and Finance to cancel the penalty if the Administrative Law Judge determines that petitioner's conduct warrants imposition of the penalty.

22. At the hearing the Audit Division presented testimony that petitioner was never told that his payments pursuant to the Deferred Payment Agreement were in satisfaction of current as well as past liability. Testimony was also offered that Department employees did not reject his attempt to pay the taxes currently due.

CONCLUSIONS OF LAW

A. That the pending bankruptcy proceeding involving FML has no bearing on petitioner's liability for withholding taxes. The penalty asserted against petitioner is "separate and independent" from FML's liability for the withholding taxes that are due (Matter of Yellin v. New York State Tax Commn., 81 AD2d 196). Therefore, it was proper for the Audit Division to issue a Notice of Deficiency to petitioner even though FML had a pending petition for bankruptcy.

B. That where a person is required to collect, truthfully account for and pay over withholding taxes and willfully fails to collect and pay over such taxes, Tax Law § 685(g) imposes on such person "a penalty equal to the total amount of tax evaded, or not collected, or not accounted for and paid over".

C. That Tax Law § 685(n) defines "person", for purposes of Tax Law § 685(g), as follows:

"the term person includes an individual, corporation or an officer or employee of any corporation (including a dissolved corporation), or a member or employee of any partnership, who as such officer, employee or member is under a duty to perform the act in respect of which the violation occurs."

D. That whether petitioner was a person required to collect, truthfully account for and pay over withholding taxes during the period in issue is a question of fact (Matter of McHugh v. State Tax Commn., 70 AD2d 987; Matter of MacLean v. State Tax Commn., 69 AD2d 951, affd 49 NY2d 920). Factors which are relevant to this determination include whether the individual signed the company's tax returns and possessed the right to hire and fire employees (Matter of Amengual v. State Tax Commn., 95 AD2d 949, 950; Matter of Malkin v. Tully, 65 AD2d 228). Other factors considered are the amount of stock owned, the authority to pay corporate obligations and the individual's official duties (Matter of Amengual v. State Tax Commn., supra).

E. That in view of petitioner's limited involvement in the financial affairs of FML, it is concluded that he was not a "person" within the meaning of Tax Law § 685(n) until July 1981. Although petitioner was the president of FML, he was an hourly worker whose duties consisted of supervising employees in the field. He was not responsible for preparing and signing FML's tax returns, paying corporate obligations or hiring and firing employees. Thus, petitioner was not a person required to collect, account for and pay over withholding taxes prior to July 1981.

F. That, in his brief, petitioner conceded that in July 1981 he became a person responsible

for collecting, accounting for and paying over withholding taxes. Therefore, the question becomes whether the failure to perform these activities was "willful".

G. That the test of whether conduct was willful within the meaning of Tax Law § 685(g) is:

"whether the act, default, or conduct is consciously and voluntarily done with knowledge that as a result, trust funds belonging to the Government will not be paid over but will be used for other purposes [citations omitted]. No showing of intent to deprive the Government of its money is necessary but only something more than accidental nonpayment is required [citations omitted]." (Matter of Levin v. Gallman, 42 NY2d 32, 34.)

H. That the crux of the willfulness standard "is that the person must voluntarily and consciously direct the trust monies from the State to someone else" (Matter of Gallo, Tax Appeals Tribunal, September 9, 1988). Therefore, a lack of knowledge that withholding taxes were not being paid over at the time of the failure would negate a finding of willfulness (Matter of Gallo, *supra*; Matter of Flax, Tax Appeals Tribunal, September 9, 1988; Matter of Lyon, Tax Appeals Tribunal, June 3, 1988). Nevertheless, if a responsible officer disregards his corporate responsibility to see that taxes are paid, the conduct can be willful despite a lack of actual knowledge (Matter of Gallo, *supra*; Matter of Lyon, *supra*; Matter of Flax, *supra*).

I. That in contrast to certain testimony presented at the hearing, it is found that petitioner was never told by a Department employee that the payments made pursuant to the Deferred Payment Agreement were in satisfaction of current as well as past liability. It is also found that Department employees did not reject his attempt to pay the taxes currently due.

Assuming that petitioner believed that the payments on the Deferred Payment Agreement were to satisfy current as well as past liabilities, the belief, under the circumstances presented herein, was so unreasonable as to constitute a reckless disregard of petitioner's responsibilities to see that taxes were paid. When petitioner first went to the Tax Department in an attempt to resolve FML's difficulties, it should have been apparent that FML's difficulties arose from its failure to pay taxes with the tax returns when due. Moreover, the terms of the Deferred Payment Agreement are clear and should have put petitioner on notice that payments pursuant to the Agreement were not in satisfaction of the current liabilities. Lastly, although the amount of the weekly payment was more than enough to satisfy the current liability, this should not have led petitioner to conclude that he was paying current liabilities because he should have also been aware that he was slowly satisfying a substantial liability.

J. That petitioner's argument that the amount of the deficiency must be limited to \$11,849.45 is without merit. The computer printout clearly shows on its face that the \$11,849.45 in tax relates to the period January 1, 1983 through September 30, 1983. Since the periods in question herein stop at the end of 1982, the \$11,849.45 amount of tax is irrelevant to the matters at issue.

K. That where a taxpayer makes a payment without a specific request as to how the funds are to be allocated, the payments may be applied as the taxing authority sees fit (see Gray v. United States, 586 F Supp 1127; Anderson v. United States, 497 F Supp 563; Matter of Farkas, Tax Appeals Tribunal, October 14, 1988). As set forth in Finding of Fact "13", five checks, which were designated as for the payment of withholding taxes, were applied to sales tax delinquencies. Since there was a specific request to apply these payments to withholding tax, they should be so allocated (see generally, Gray v. United States, *supra*;

Anderson v. United States, supra). It is noted that since the checks do not designate a specific withholding tax period, they may be applied by the Department to any outstanding withholding tax which precedes the date on the check.

L. That the Audit Division is directed to reduce the asserted deficiency of tax for the year 1981 in accordance with Finding of Fact "16".

M. That petitioner's request pursuant to Tax Law § 685(g) to remand this matter to the Department to waive the penalty is denied. In accordance with Tax Law § 2006(12), the penalty issue is properly before the Division of Tax Appeals.

N. That the petition of Michael Lenhard is granted to the extent of Conclusions of Law "E", "K" and "L", and the Notice of Deficiency issued May 21, 1984 is otherwise sustained.

DATED: Albany, New York
October 20, 1988

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE